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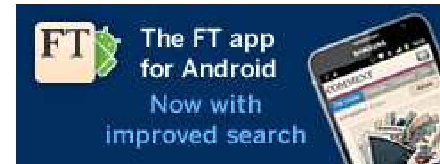

FINANCIAL TIMES

Stimulating Europe

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Strategies to overcome the European crisis only focused on collective austerity are not working; they are bad arithmetic, worse economics and ignore the lessons of history. A key missing ingredient is the urgent restoration of growth, which European citizens demand and several leaders are increasingly stressing. However, meaningful actions on a sufficient scale have not yet been taken.

One specific way of significantly stimulating European growth would be to greatly expand lending by the European Investment Bank (EIB) within Europe, so that it could finance increased investment, especially but not only in the countries suffering most from the crisis. By boosting investment to help restructure those economies with viable projects and make them more competitive, this could have positive medium-term supply effects; in the short-term it would also contribute to expanding aggregate demand in all European countries, lifting growth and employment.

One crucial advantage of this proposal is that with fairly limited public resources, a very large impact on investment, growth and employment can be achieved with the benefits of leverage. A second major advantage is that, as an existing successful European institution – the EIB – can be used. The measures can be quickly implemented.

There are two promising paths to use limited public resources to achieve important multiplier effects. The first is to achieve leverage with the EU budget. A very small amount (as proportion of the EU budget), equal to €5bn a year could be allocated as a risk buffer. This would allow the EIB to lend an additional €10bn annually both for financing infrastructure projects (project bonds) as well as projects to promote innovation. The project bonds would imply that 25% of the project would be advanced by a private investor, the EIB would finance the next 25%; with a mezzanine tranche; the remainder would be invested by pension funds and insurance companies; regarding the mezzanine tranche, the EU contribution would finance half the risk assumed by the EIB. Thus, €5 bn from the EU budget- leading to financing by the EIB of €10bn- would lead to project finance of €40bn annually.

The second path is to increase EIB capital by EU member states. Only a very small proportion of capital, (5%) has to be paid-in. Therefore if this paid-in capital is doubled, it would require only a total of €11.6bn from EU member states. Rating agencies accept a leverage of eight for the EIB to maintain its AAA status. Therefore, an increase of paid-in equity of around €12bn would allow the EIB to expand its lending by €95bn, which is an impressive multiplier. If this additional EIB lending was spread over the next four years, an additional €10bn could be lent in 2012, €35bn additional lending could be done in 2013, and €35bn could be lent annually in both 2014 and 2015. Because typically the EIB co-finances 50% of projects, with private sector or others contributing the other 50%, this would result in additional investment of €190bn.

To this programme of significantly enhanced EIB lending could be added some additional resources from the EU budget, to an important extent drawing till end 2013 from existing unused European Structural Funds. Further funds could be easily allocated to growth from the new EU budget from 2014 onwards of €25bn annually.

In total the additional EIB and EU resources allocated to growth could reach €35bn in 2012 and go to €60bn annually in the 2013-2015 . The resources for 2013-2015 would correspond to around 0.5% of EU annual GDP. As they would be allocated to finance increased investment and working capital, the latter for small and medium enterprises, this would have a major impact on EU growth and employment. It is interesting that these resources, with a total dimension of almost 2% of EU GDP would be similar, though somewhat smaller, to those of the Marshall Plan. Hopefully they would also contribute to a significant renewal of growth dynamic in Europe.

It is both feasible and urgent to set up a reliable investment program of this size, to foster a growth impulse that carries Europe forward.

We have estimated the impact that such a programme could have on EU growth and employment in 2013 and 2014, with the help of the international macroeconomic model HEIMDAL. We use conservative assumptions for the impact on investment, of half of the additional EIB and EU resources in 2013 and 2/3 in 2014. We also assume the most affected countries (such as Greece, Portugal, Spain, and Italy) would receive the greater part of the resources.

The modelling shows that such a programme would result in a minimum additional increase of average EU GDP of almost 0.6% in two years. Furthermore, more than half a million jobs would be already created in 2013, with **accumulated additional EU job increases of over 1.2m by 2014.** The southern European economies would have larger percentage increases than the average, though all EU countries would benefit, due to the important cumulative effects not just of increased investment at home, but also of increased European trade.

This figure does not include effects of increased EIB lending, via commercial banks to provide much needed working capital to credit constrained small and medium

enterprises, which will stabilise or increase employment and output significantly further. Last but not least, growing confidence will result in increased private investments which are not included here, too. The impact on jobs will clearly be well above 1.2m.

It is urgent to act now and lay the foundations for renewed European growth and job creation. Our proposals offer a concrete, feasible and cost-effective way of doing exactly that. It is for EU leaders in their next summit to take such or similar measures on a sufficient scale and with the necessary speed that the difficult situation requires.

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